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Weak Fourth-Quarter Results Cast Shadow On Strong Annual GNP Figure

Last year economic growth in Japan came in like a lion and went out like a lamb. That assessment helps make sense of the 1991 gross national product statistics released March 19 by the Economic Planning Agency. Although the January-March inflation-adjusted annualized growth registered an astounding 8.3 percent, the expansion slowed in each of the three remaining periods. In the fourth quarter the economy posted an annualized decline of 0.2 percent, the first quarter-to-quarter drop in two-and-a-half years (see Table).

For 1991 as a whole GNP grew 4.5 percent in real terms. Although that rate of expansion was the slowest since the 4.3 percent rise registered in 1987, Japan's overall economic performance was strong compared to other industrial nations. Using gross domestic product for comparison, real U.S. output shrank 0.7 percent in 1991, while the former West Germany's inflation-adjusted GDP grew only 3.1 percent; Japan registered a 4.4 percent gain on a GDP basis. However, while the economy of the United States slowly regained its feet during 1991, the other two nations had trouble keeping their balance in the second half of the year. As a result, the American economy, as measured by GDP growth, was stronger than that of either Japan or Germany in the last two quarters of 1991.

The October-December quarter results for Japan, along with more recent indicators in both countries, suggest that the U.S. economy could outperform Japan's over the coming few months as well. In the words of the usually restrained Yutaka Kosai, head of the private Japan Economic Research Center, the fourth-quarter data represented "on the whole, extremely weak figures." Indeed, one need not look far in the statistics to find evidence of a slowdown. For example, business inventories, while accumulating more slowly than in the previous quarter, continued to increase

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	1990	1991	January-March 1991	April-June 1991	July-September 1991	October-December 1991
Gross Domestic Product	n.a.	¥418,374.0	¥414,372.6	¥418,446.7	¥420,211.8	¥420,282.0
	(n.a.)	(4.4%)	(6.7%)	(4.0%)	(1.7%)	(0.1%)
Gross National Product	¥403,371.7	421,322.5	418,093.0	421,003.9	423,052.8	422,859.2
	(5.2%)	(4.5%)	(8.3%)	(2.8%)	(2.0%)	(-0.2%)
Personal Consumption Spending	232,581.5	238,740.8	234,948.3	238,652.2	240,449.8	240,667.2
	(4.2%)	(2.6%)	(2.3%)	(6.5%)	(3.0%)	(0.4%)
Private Residential Construction	22,751.4	20,933.5	22,576.7	21,110.7	20,620.8	19,598.4
	(4.6%)	(-8.0%)	(-7.1%)	(-23.6%)	(-9.0%)	(-18.4%)
Private Fixed Nonresidential Investment	86,659.8	91,927.4	92,263.4	91,559.7	92,225.3	91,638.3
	(12.4%)	(6.1%)	(9.2%)	(-3.0%)	(2.9%)	(-2.5%)
Change in Business Inventories	2,701.9	3,231.0	3,071.8	3,172.3	3,420.9	3,252.1
	(-28.5%)	(19.6%)	(76.2%)	(13.7%)	(35.2%)	(-18.3%)
Government Current Expenditures	34,116.0	35,262.8	35,036.8	35,595.7	35,114.8	35,295.0
	(1.9%)	(3.4%)	(6.1%)	(6.5%)	(-5.3%)	(2.1%)
Government Fixed Investment	25,920.8	27,171.2	26,143.3	27,378.4	27,392.6	27,721.1
	(4.6%)	(4.8%)	(2.5%)	(20.3%)	(0.2%)	(4.9%)
Change in Government Inventories	86.2	-206.5	80.2	-199.8	240.8	-942.6
	(*)	(*)	(*)	(*)	(*)	(*)
Net External Sector	-1,445.9	4,262.2	3,972.5	3,734.7	3,587.8	5,629.7
	(*)	(*)	(*)	(*)	(*)	(*)
Exports of Goods and Services and Factor Income Received	72,810.0	76,477.9	76,508.5	74,796.4	76,671.6	77,843.7
	(10.7%)	(5.0%)	(17.8%)	(-8.7%)	(10.4%)	(6.3%)
Imports of Goods and Services and Factor Income Paid	74,255.9	72,215.7	72,536.0	71,061.7	73,083.8	72,214.0
	(12.0%)	(-2.7%)	(-2.9%)	(-7.9%)	(11.9%)	(-4.7%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

rapidly. This finding suggests that further cuts in production levels are likely at Japanese firms, with attendant consequences for aggregate output. Other data were equally bleak. Despite the decline in long-term interest rates that began last July, housing construction continued to decline. Consumer spending, which accounted for 56.9 percent of real GNP in the year's final quarter, responded adversely to the economy's overall weakness and inched ahead a mere 0.4 percent on an annualized basis.

Even the one apparent bright spot in the data actually represented bad news for Japan's policymakers; the real trade surplus on a GNP basis surged in the fourth quarter, adding 0.5 percentage point to the quarterly growth rate. In other words, other factors equal, the Japanese economy in the October-December period would have shrunk approximately 2 percent on an annualized basis without the increase in net exports. However, expanding exports and shrinking imports is not a sustainable source of growth, particularly when trade frictions with major trading partners are a prime concern. Tokyo knows that a strong trade performance during a period of slow growth worldwide is political dynamite.

Most discouraging of all the fourth-quarter figures were those for plant and equipment spending. In recent years business investment has accounted for a high fraction of Japan's overall economic growth; last year it equaled 21.8 percent of real GNP. A revival of capital spending, while not absolutely necessary, would help tremendously in making Japan's recession a short one. Yet, like housing, corporate fixed investment has not responded to the lower interest rates prevailing since July, remaining at roughly the same level in 1991's four quarters; in the most recent period it declined at an annualized rate of 2.5 percent. A recent EPA survey suggested that capital spending is likely to decline further over the next six months. Surveys of corporate investment plans for FY 1992 suggest a drop over the full fiscal year as well. (For details, see *JEI Report* No. 11B, March 20, 1992.)

Based on the disappointing fourth-quarter figures, as well as the pessimistic forecasts for investment spending and other data, many — but by no means all — forecasters believe that GNP will shrink again during the January-March period. Back-to-back declines in Japan's quarterly GNP, a first since the 1973-75 oil crisis, would qualify as a recession even by U.S. standards. For Japan, where at least one period has been labeled as recessionary without even a single quarter of declining GNP, that development would come as a distinct shock.

Douglas Ostrom

Tokyo Aiming To Prime Economic Pump

Prime Minister Kiichi Miyazawa's government is rushing to flesh out its plan to prime the nation's economic pump but is encountering difficulties in developing a consensus on specific measures. While there is general agreement that something needs to be done quickly to prevent the economy from sliding deeper into recession, the Ministry of Finance remains firmly opposed to sharp increases in deficit spending — a textbook fiscal tool for stimulating the economy. In addition, speculation continues to swirl regarding when the Bank of Japan will cut the discount rate and how deep the reduction will be. Strong pressure from nearly all quarters for a quick, deep cut has encountered BOJ concerns over reigniting inflation and financial speculation. The central bank also has resisted pressures, observers say, to help defend its policymaking independence.

The private sector is waiting anxiously to see to what extent the Miyazawa government will add substance to the bare bones of the five-point economic stimulus plan announced in early March. That program specifies:

- Spending 75 to 80 percent of budgeted FY 1992 funds for public works in the first half of the fiscal year. The prime minister is asking the relevant ministries and local governments to draw up lists of projects for quick action after the new fiscal year begins April 1.

visit, the Ministry of Foreign Affairs reportedly indicated that Japan is ready to contribute its share of an IMF fund to help stabilize the value of the ruble. The Japanese foreign minister also conveyed Tokyo's backing of a proposal to remove lending limits at the European Bank of Reconstruction and Development for CIS members. EBRD agreed in January to repeal the loan ceiling, which was set at 36 million European Currency Units per year. The two foreign ministers concurred that the pending $100 million in Export-Import Bank of Japan loans should be delivered as soon as possible. Mr. Watanabe tried to impress on his counterpart, however, the importance of Russia resuming interest payments on debts owed by the former Soviet Union to Western lending nations. Mr. Kozyrev evidently said that only technical problems remain before CIS assumes joint responsibility for the debt repayments.

Although no breakthroughs were achieved, Japanese officials nevertheless were pleased with Mr. Kozyrev's visit, viewing it as a harbinger of progress. "After being deadlocked for decades, it is impossible to settle the dispute in one year," Mr. Watanabe told reporters following his meetings with the Russian foreign minister. He said Japan will take a "step-by-step" approach to resolving the Northern Territories issue. The Japanese foreign minister also expressed hope that a "certain direction" for solving the territorial dispute will be decided in time for Mr. Yeltsin's fall visit.

Barbara Wanner

Tokyo Cuts Car Export Quota

Can an extra dose of managed trade deflate pressure on Capitol Hill and in Detroit for a cap on Japan's overall share of the American car market? The Ministry of International Trade and Industry certainly hopes so. On March 19 MITI Minister Kozo Watanabe announced that the 11-year-old ceiling on U.S.-bound car exports would be lowered to 1,650,000 units at the start of April from 2,300,000 units, the annual quota since the beginning of FY 1985. Although taken as a given by trade and industry analysts in the aftermath of President Bush's early January Japan trip, the decision to tighten the restraints was not merely a reflexive response to the heightened transpacific noise level. MITI policymakers knew that a quota cut could send the wrong signals to automotive-state legislators and car and truck manufacturers in the United States (see *JEI Report* No. 5B, February 7, 1992). They also worried that such a move would spark fresh demands from France and Italy for a similar reduction in the ceiling on shipments of Japanese-made cars to the European Community, which goes into effect next year and lasts through 1998.

In the final analysis, though, the biggest drawback to the reduction option was practical: coming up with a quota figure that would score political points in the United States yet not wreak havoc with Japanese automotive manufacturers' U.S. marketing operations. Adoption of any of the export numbers deemed meaningful by Detroit, such as an annual limit of 1,300,000 cars (see *JEI Report* No. 13B, April 5, 1991) or even 1,000,000 units, apparently was ruled out from the start because of the deep shipment cuts that would be required. At the same time MITI decisionmakers no doubt recognized that setting the ceiling close to either FY 1990's actual export level — 1,849,631 — or the current fiscal year's projected tally — 1,717,692 based on a straight-line extrapolation of shipments during the April 1991-January 1992 period or 1,730,000, according to MITI's calculations — would be dismissed in the United States as an empty gesture.

Realizing that each of their other alternatives — scrapping the export ceiling altogether, maintaining the cap at 2,300,000 units or cutting the quota to FY 1991's shipment level — also had drawbacks, MITI officials went with option four and a number that would require some sacrifice by Japan's motor vehicle industry but not cause major dislocations. The reaction from Detroit was predictable. "They give the misleading impression that something meaningful is being done to reduce the U.S. trade deficit with Japan," General Motors Corp. said in a statement. Added Ford Motor Co. chairman Harold Poling, "All that has happened is that the Japanese government has proposed a

voluntary level for 1992 at about the same volume their auto makers imported in the United States from Japan in 1991." Chrysler Corp. similarly argued, "They've simply set the new limit at their current sales level." The number-three U.S. automotive maker used its statement to make a new pitch to slash the quota to 1,000,000 cars a year to "get back to a level playing field for everybody."

Detroit's verdict aside, the 1,650,000-unit quota could make Japan's export restraints economically relevant for the first time since at least 1988 if, as expected, U.S. car sales reverse course this year. Japanese automotive manufacturers that build cars here — Honda Motor Co., Ltd., Toyota Motor Corp., Nissan Motor Co., Ltd., Mazda Motor Corp., Mitsubishi Motors Corp. and Fuji Heavy Industries, Ltd. (Subaru) — obviously have some flexibility to handle stronger demand for their top-selling models. Some of these same companies, however, might have to juggle their made-in-Japan product mix, choosing between maintaining exports of slower-selling but higher-profit models or supplying enough cars in high-volume, low-margin lines. Toyota, for example, could be faced with the dilemma of going after first-time car buyers and trying to improve on the 102,000 entry-level Tercels sold in 1991, or catering to buyers in the luxury class, where its Lexus line had sales last year of 71,200 units.

Of course, this problem might not materialize if prospective car buyers are turned off by the current sticker prices on Japanese nameplates. The American marketing arms of Japan's automotive makers raised prices at the start of the 1992 model year and again this month, ostensibly to cover the yen's appreciation in the intervening period. For Honda-, Toyota- and Nissan-badged cars these two increases totaled as much as $955 on a sales-weighted basis. The U.S. Big Three, in contrast, upped their prices by a sales-weighted average of $540 at introduction time but have said they will hold the line for the rest of the 1992 model year even if their Japanese competitors find it politically or economically prudent to hike prices again.

To some extent the marketing and pricing strategies adopted by Japanese car makers in the United States will depend on how MITI allocates the 1,650,000-unit export quota for FY 1992. Sources have said the ministry will not take a straight 28.3 percent off the top of each exporter's existing allotment (see Table). Instead, shipment levels will be decided company by company, reflecting such

Unofficial Quota Allocations, FY 1981-FY 1991

(in units)

Exporter	FY 1981-FY 1983 Quota	FY 1984 Quota	FY 1985-FY 1986 Quota	FY 1987 Quota	FY 1988 Quota	FY 1989-FY 1991 Quota
Toyota Motor Corp.	516,659	551,792	616,900	613,816	612,350	610,350
Nissan Motor Co., Ltd.	456,030	487,040	544,500	541,778	540,500	532,500
Honda Motor Co., Ltd.	348,631	372,338	427,000	424,865	423,850	421,850
Mazda Motor Corp.	159,282	173,468	227,800	226,661	226,100	226,100
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	195,100	194,125	193,650	193,650
Isuzu Motors Ltd. (including sales to General Motors Corp.)	16,800	49,500	120,400	119,798	119,500	124,500
Fuji Heavy Industries, Ltd.	70,014	76,250	107,600	107,062	106,800	106,800
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	60,700	60,397	60,250	64,250
Daihatsu Motor Co., Ltd.	0	0	0	11,498	17,000	20,000
Total	1,680,000	1,850,000	2,300,000	2,300,000	2,300,000	2,300,000

factors as whether an exporter has been filling its quota, the manufacturer's American sales record and its export plans for the coming fiscal year, U.S. production capabilities and the firm's financial health.

Depending on how much weight is given to the last variable, Isuzu Motors Ltd. might be immune to a cut in its allocation. Fuji Heavy Industries' finances, although in better shape than Isuzu's, might qualify it for special consideration as well. MITI planners also could decide to give Isuzu a break simply because it supplies cars to GM. If that is the case, then Suzuki Motor Co., Ltd., another GM supplier, and MMC, which makes Chrysler-badged cars, should get comparable treatment. Those exceptions would shift the brunt of the quota cutback to Toyota, Nissan, Honda and Mazda, probably in that order. But as the four biggest exporters these companies no doubt knew what was in store for them even before MITI officials indicated that their allocation decisions would be guided by a checklist.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.